**Deconstructing the property tax**

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One of the significant measures to meet the demands of the International Monetary Fund is the tax revenue target of Rs7,004 billion of the Federal Board of Revenue for FY2022-23, a 16.7 per cent increase from the previous year.

The FBR, in its dual role of tax policymaker and tax collection authority, has proposed a new source of taxation of deemed rental income based on the capital value of immovable property under section 7E in the Income Tax Ordinance, 2001 (‘ITO 2001’) proposed through the Finance Bill, 2022. Under the proposed amendment, subject to certain exceptions, a resident person shall be deemed to receive rent equal to five per cent of the fair market value of such property situated in Pakistan, which is proposed to be taxed for tax year 2022 and onwards at the rate of 20 per cent.

The fiscal laws are no stranger to the deeming provisions, which create a legal fiction to impose tax on an income that is not actually accrued. The courts, however, strictly construe such provisions in relation to their underlying purpose and the domain of the enacting legislature.

Keeping aside the inherent legal issues, the proposed tax only burdens the existing taxpayers as no effort has been made to widen the tax base. The number of people filing their tax returns was around three million for tax year 2021. The proposed section 7E does not enable the FBR to widen this tax base. Those who are not filing their tax returns will continue to remain indifferent, if not reluctant, to file their tax returns. Therefore, practically, this proposed addition may only lead to burdening the already compliant taxpayers with no impact on persons out of the tax net.

The Indian Tax Act, 1961 levied a similar tax under sections 22 and 23. These provisions were challenged in Sakarlal Balabhai v Income Tax Officer [(1975) 100 ITR 97 (Guj)]. The Gujarat High Court upheld their legality on the grounds that a notional letting value of property can be taxed, as it would be considered as "income" under the Income Tax Act; and that it falls within the ambit of the legislative competence of the parliament of India under entry No 82 of List I (the ‘Union List’) of the 7th Schedule to the constitution of India, 1949 – that is: "taxes on income other than agricultural income". The corresponding entry in the Federal Legislative List of the 4th Schedule to the constitution of Pakistan, 1973 is entry 47: “taxes on income other than agricultural income". Based on this, the federal legislature may impose tax on deemed income under the proposed section 7E.

However, one of the stark differences in the legislative lists of the two countries is the presence of entry 50 in the constitution of Pakistan, which limits the federal legislative domain by listing "taxes on the capital value of the assets, not including taxes on immovable property". It is noteworthy that, unlike the Federal Legislative List, the Union List does not create any specific exclusion with respect to immovable property, and instead provides broad legislative powers to the Indian federal legislature by including "any other matter not enumerated in List II or List III including any tax not mentioned in either of those Lists" in the Union List. In contrast, the residual legislative powers for subjects not mentioned in the Federal Legislative List vests with the provinces as a result of the 18th Amendment to the constitution, which aimed at providing more financial and legislative autonomy to the provinces.

It is pertinent to note that prior to the 18th Amendment, entry No 50 of the Federal Legislative List empowered the federal legislature to levy taxes on the capital value of assets, not including taxes on capital gains on immovable property. However, the words “on capital gains” were omitted by the 18th Amendment, which effectively made the taxation on capital value of immovable property a provincial subject. This shows that the federal legislature surrendered the right to levy tax on capital value for the levy of tax on capital gains. Further, the FBR, vide Circular No 02 of 2012, dated July 27, 2012 also explained that the effect of omission of these words is that the federal legislature cannot impose taxes on capital value of immoveable property, but can only levy tax on capital gains on the disposal of immoveable property.

It is important to note that the tax under the proposed section 7E is being charged on the value of the immovable property (five per cent of fair market value). From the bare perusal of the proposed amendment, it can be argued that the federal legislature is indirectly trying to impose tax on the capital value of immovable properties. This not only takes it out of the ambit of the federal legislature but also goes against the well-settled principle that what cannot be done directly can also not be done indirectly.

It seems that the federal legislature, by taking a page from the neighbour's book, has relied on entry 47 of the Federal Legislative List to impose tax under the proposed section 7E. However, even reliance on entry 47 creates some significant legal lacunas. Equality before law is a fundamental right guaranteed by Article 25 of the constitution of Pakistan. As evident from its language, the proposed amendment aims at taxing the deemed rental income from a land, whether the said land is being used for an income generating purpose or not. It will be a legal challenge for the proponents to justify the taxation on a similar scale on lands with different characteristics.

Reliance in this regard may be placed on Kunnatha Thathunni Moopil Nair etc v State of Kerala and another (AIR 1961 SC 552) wherein the Supreme Court of India examined the vires of a state act imposing a basic tax on holding of lands at a uniform rate, irrespective of the description of land and the tenure for which they were held. The court ruled that guarantee of equal protection of laws must extend even to taxing statutes and the levy of the tax at a uniform rate on the lands, without any classification, was against the fundamental right to be treated equally, as it would create a situation whereby a person making nothing out of his land and a person making profits from his land would both be taxed in a similar manner.

Further, one of the leading themes of the Finance Bill, 2022 is to tax the wealthy. If the tax is being levied with this intention, then that would mean that the tax is being imposed by the federal legislature on holding immovable property, which clearly comes under the ambit of the provincial legislature. No matter how noble the cause, the end does not justify the means and similarly extra-legislative actions do not justify imposition of taxes by ignoring the legal boundaries and the provided legislative procedures. Be that as it may, the proposed section 7E of the ITO will raise important legal challenges before the courts as it will try to interpret the deeming powers of the legislative bodies while keeping in view the legal principles laid down by the constitution of Pakistan.